

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2011-317-WS - ORDER NO. 2012-98
FEBRUARY 8, 2012

IN RE: Application of Kiawah Island Utility, Inc. for) ORDER RULING ON
Adjustment of Rates and Charges) APPLICATION FOR
) INCREASE IN RATES
) AND CHARGES

I. Introduction

This matter is before the Public Service Commission of South Carolina (the “Commission”) on the Application of Kiawah Island Utility, Inc. (“KIU” or “the Company”) filed on August 4, 2011, seeking approval of a new schedule of rates and charges for water and sewer service that KIU provides to its customers within its authorized service area in South Carolina. The Application was filed pursuant to S.C. Code Ann. Section 58-5-240 and 26 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A. KIU’s South Carolina operations are classified by the National Association of Regulatory Utility Commissioners (“NARUC”) as a Class A water and wastewater utility according to water and sewer revenues reported on its Application for the test year ending December 31, 2010. The Commission approved service area for KIU is Kiawah Island located in Charleston County, South Carolina.

In considering the Application of KIU, the Commission must ascertain and fix just and reasonable rates, standards, classifications, regulations, practices, and measurements of service to be furnished. Thus, the Commission must give due

consideration to the Company's total revenue requirements and review the operating revenues and operating expenses of KIU to establish adequate and reasonable levels of revenues and expenses. The Commission will consider a fair rate of return for KIU based on the record, and any increase must be just and reasonable and free of undue discrimination.

By letter dated August 15, 2011, the Commission's Clerk's Office instructed KIU to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the area affected by KIU's Application. The Notice of Filing described the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record. In the letter of August 15, 2011, the Commission also instructed KIU to notify directly, by U.S. Mail, each customer affected by the Application by mailing each customer a copy of the Notice of Filing. KIU filed Affidavits of Publication demonstrating that the Notice of Filing had been duly published and provided a letter certifying that it had complied with the instructions of the Commission's Clerk's Office and mailed a copy of the Notice of Filing to all customers.

In response to the Notice of Filing, Petitions to Intervene were filed on behalf of the Kiawah Island Property Owners' Group, Inc. ("KPOG") on September 8, 2011, and the Kiawah Island Community Association, Inc. ("KICA") on September 16, 2011. The Petition to Intervene of KPOG also included a request for the Commission to schedule a public hearing.

In response to the request for public hearing, the Commission held a public night hearing pursuant to Order No. 2011-666.¹ Under this Order, a public hearing was set and noticed by the Commission, and the Company provided affidavits certifying that it had provided notice to its customers via U.S. Mail of the date, time, and location of the local public hearing. On October 20, 2011, the Commission held a night hearing at the Kiawah Island Golf Resort, Governor's Hall, 5490 Sea Forrest Dr., Kiawah Island, South Carolina. The Commission, with Chairman Howard presiding, heard the matter of KIU's Application beginning at 10:30 am on November 30, 2011, at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina.

During the proceedings, KIU was represented by G. Trenholm Walker, Esquire. KPOG was represented by Michael A. Molony, Esquire. KICA was represented by Jason S. Luck, Esquire. The Office of Regulatory Staff ("ORS") was represented by Shannon Bowyer Hudson, Esquire, and Jeffrey M. Nelson, Esquire.

At the hearing held on November 30, KIU presented the testimony of Becky Dennis, General Manager of KIU; Steve D. Heyboer, Chief Financial Officer of KIU; J. Mitchell Bohannon, III, a professional engineer employed by the firm of Thomas & Hutton Engineering Co.; Gary C. White, Vice President and Director of Accounting with the firm of Guastella Associates, LLC; and John F. Guastella, President of Guastella Associates, LLC, a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts.

¹ The purpose of the night hearing was to provide a forum, at a convenient time and location, for customers of KIU to present their comments regarding the service and rates of KIU.

KPOG presented the testimony of Lynn M. Lanier and Ellen Blumenthal, both employees of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia. The parties agreed to stipulate into the record the pre-filed testimony of KPOG witnesses Diane Lehder and Wendy Kulick. KPOG had also pre-filed direct testimony by William D. Rogers, who did not appear at the hearing. KICA did not pre-file or present the testimony of any witnesses at the Commission hearing.

The ORS presented the testimonies of ORS Auditor Daniel F. Sullivan and Hannah K. Majewski of the ORS Water and Wastewater Department. Mr. Sullivan's direct testimony described ORS's examinations of the Application and KIU's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. Ms. Majewski's direct testimony focused on KIU's compliance with Commission rules and regulations, ORS's business audit of KIU's water and wastewater systems, test-year and proposed revenue, and performance bond requirements.

The Commission issued an interim order on February 1, 2012, which adopted the proposed order of the Office of Regulatory Staff with several modifications. KIU was instructed to remove all expenses relating to the Cougar Island purchase and to adjust the federal income tax rate to 34%. In conformity with the Commission's instruction, and with the assistance of the ORS, new financial data and revised rates were filed with the Commission and served on all parties by February 6, 2012, to reflect these changes (KIU's Statement Of Compliance With PSC Interim Order).

II. Findings of Fact

1. KIU is a water and sewer utility providing water and sewer service in its assigned service area on Kiawah Island, Charleston County, South Carolina. Its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. Section 58-5-10, *et. seq.* (1976), as amended.

2. The appropriate test year period for this proceeding, selected by the Company, is January 1, 2010, through December 31, 2010.

3. Based on the Application of KIU and the evidence presented to the Commission by the parties, the Commission will use an operating margin methodology in determining the lawfulness of the Company's rates and in fixing just and reasonable rates.

4. A fair and reasonable Operating Margin for KIU is 13.75%.

5. KIU is entitled to total rate case expenses of \$190,905, which includes additional rate case expenses of \$57,341 incurred in this rate case and paid by KIU as of December 29, 2011. Rate case expenses shall be amortized over a period of five years, ($\$190,905/5 \text{ years} = \$38,181 \text{ per year}$) and are reflected in this Order.

6. KIU is seeking an increase in its rates and charges for water and sewer service; at KIU's proposed rates (for "Phase I" as KIU at the hearing withdrew its request that the Commission rule on its post-construction "Phase II" rates at this time) the additional total operating revenues would be \$1,046,694.

7. The appropriate operating revenue for KIU, for the test year, under present rates, and after accounting and pro forma adjustments is \$5,697,698.

8. The appropriate operating expenses for KIU for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of-test-year occurrences are \$4,921,182.

9. A customer growth adjustment, using the method of calculating customer growth as proposed by ORS, is included in computing the net income for return requirement of KIU.

10. The total operating revenue requirement for KIU, using the operating margin of 13.75% found appropriate in this Order, is \$6,457,165.

11. In order for KIU to have the opportunity to earn its total operating revenue requirement of \$6,457,165, KIU must be allowed additional revenues totaling \$759,467.

12. All parties in this docket testified as to the need for the construction of a second water supply line to Kiawah Island to ensure a reliable supply of water. As of the date of the hearing in this case, however, KIU has not requested or received construction bids for the construction of the second water supply line. It is therefore too early for this Commission to consider or grant prospective rates based on the costs of building a second water supply line. As indicated, KIU withdrew its request that the Commission rule on its "Phase II" rate increase to pay for the cost of the second line.

13. The current tariff provision and conditions regarding the pass through mechanism for increases in bulk water rates from the St. John's Water Company for purchased water is reaffirmed, and the Company is ordered to follow the notice provisions to customers to implement such increases as provided by the Commission in Order No. 2002-285.

III. Evidence and Conclusions

1. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence supporting this finding, concerning the Company's business and legal status, is contained in the Application filed by KIU, testimony, and in prior Commission orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is informational, procedural, and jurisdictional in nature, and the matters which it involves are not contested by any party.

2. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 2

The evidence supporting this finding, that the appropriate test year period for this proceeding is January 1, 2010, through December 31, 2010, is contained in the Application filed by KIU and in the testimony and exhibits of the Company and ORS. No party contested the use of the test year proposed by KIU in its Application. The Commission concludes that the test year ending December 31, 2010, is appropriate.

3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

In its Application, KIU requested rates set on an operating margin basis. The Commission has adjusted rates based on the operating margin in all previous rate applications of KIU. Intervenor KPOG, supported by Intervenor KICA, contested the use of operating margin to set KIU's rates and argued that rates should be, instead, calculated on a rate of return, or rate base, methodology. While the Commission concedes that there is no requirement that operating margin methodology be used in determining a fair rate of return, KIU requested operating margin treatment in its Application and ORS performed its audit and calculations and recommendation based on an operating margin

methodology. Additionally, although the Intervenors presented certain testimony on their contentions as to a suitable return on equity for KIU, there was no credible testimony or evidence presented by any party to establish what an appropriate return on equity would be for a comparable water and wastewater utility. Absent credible proof of a comprehensive analysis to establish rates based on return on equity, the Commission finds that the weight of the evidence, including the testimony of witnesses Guastella, White, Sullivan, and Majewski as to their respective determinations associated with the operating margin analysis, supports the use of an operating margin methodology to determine a fair rate of return in this case.

Therefore, despite the Intervenors' arguments that the petitioner Company should seek an alternative method to determine a fair rate of return, the Commission finds that an operating margin methodology is appropriate. Additionally, the Commission finds based on the testimony of witnesses Dennis, Heyboer, and Guastella supported by the testimony of witnesses Sullivan and Majewski, that an increase in rates is justified and fair. As the KIU witnesses testified, several expenses other than purchased water have increased during the last ten years, which was the last time the Company sought a rate increase, and the Company is entitled to a fair and reasonable increase to allow it to serve its customers at the same level and put it in more favorable position to borrow or acquire capital.

4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

In calculating an appropriate operating margin in this case, we give significant weight to the direct, rebuttal, and supplemental rebuttal testimony of Company witness Guastella and the direct testimony of ORS witness Majewski. Witness Guastella testified

to several reasons that support an operating margin of 13.75% including KIU's need to have the ability to attract capital and provide a fair return to its owner. He also testified that operating margin is an accepted and widely used method of rate setting. ORS, in accord with its testimony in numerous previous operating margin cases, recommended that KIU be allowed an operating margin of between 10% and 15%. Witness Guastella does not dispute this recommendation but in fact testified that he believed that an operating margin of 13.75% would be fair to the customers of KIU and would also allow KIU to earn a fair return. In response to questioning from Commissioner Fleming, witness Majewski stated that ORS would be agreeable to KIU receiving a 13.75% operating margin, as attested by witness Guastella. (Hearing Tr. 461). The following table illustrates an operating margin of 13.75% after the approved increase:

Table A

Operating Revenue	\$6,457,165
Operating Expenses	<u>\$5,209,136</u>
Operating Income	\$1,248,029
Add: Customer Growth	\$6,966
Less: Interest Expense	<u>\$367,037</u>
Net Income for Operating Margin	\$887,958
Operating Margin	13.75%

Although the Intervenor's witnesses primarily testified to the propriety of this Commission setting rates based on a return on equity basis, witnesses Lanier and

Blumenthal also provided testimony regarding what they believed to be a fair and appropriate operating margin for KIU. Witness Blumenthal also recommended adjustments for certain affiliated transactions, property sales/contributions, and return on equity calculations.

The record of this case evidences that KIU has provided adequate customer and billing services. The only complaints voiced by the Intervenors and public witnesses in this case seemed to focus on the issues of the relationship between KIU and its parent, Kiawah Resort Associates, LP (“KRA”), and the use of a return on equity versus operating margin methodology in setting KIU’s rates. As stated, we find that an operating margin methodology is the proper method to establish rates in this matter.

Additionally, we find convincing the testimony of ORS witnesses Majewski and Sullivan that the property leases and sales between KIU and KRA, management fees, and other operating expenses of KIU are allowable and accurate, as adjusted and specified in Audit Exhibit DFS-1 of Hearing Exhibit No. 12, with the exception of the sale of the Cougar Island property, which will be discussed further below.

In support of allowing the \$100,000 management fee paid to the owner, KRA, as an expense for the test year, the Commission relies additionally on the extensive testimony of witnesses Heyboer and Guastella. They testified to the facts supporting our determination that the annual management fee is fair and reasonable. Their testimony went into detail as to the array of services provided by KRA to KIU, including but not limited to, human resources, placement of insurance, communications and marketing, financial management, and overall management. KRA’s provision of these services

eliminates significant expenses that KIU would incur if it had to hire its own personnel or consultants to provide them. Witness Guastella attested that the percentage of revenues dedicated to management and administration by KIU is low when compared to other water and sewer utilities that reported this information.

There was no evidence to support Intervenor's argument that the building incentive fees collected by KRA should be considered revenue. KIU does not collect these fees. As the KIU witnesses testified, these fees are not paid to insure the availability of water and sewer services.

We also reject Intervenor KPOG's argument, based primarily on the testimony of witness Blumenthal, that the interest expense for the loans for the acquisition of the three parcels should be disallowed, other than the interest expense for the loan for the acquisition of Cougar Island. KIU paid the following purchase prices to KRA for the acquisition of the following parcels: \$1,360,000 for the Down-Island storage property in 2008; \$1,800,000 for the Holding Pond property in 2009; and \$2,000,000 for the Cougar Island ASR tract in 2010. Witness Heyboer testified that KIU entered leases for the first two in the mid-1990s since KIU did not then have the funds or the borrowing capacity to purchase them. He testified that the purchase price for these two was for the land only and for fair market value based on independent appraisals. Heyboer also noted that there were purchase clauses contained in the lease agreements. According to Heyboer, the purchase price for the Cougar Island ASR tract was the lower of two per acre valuations in two separate appraisals that determined fair market value for acreage on Cougar Island.

We find based on the testimony of witness Dennis that the two parcels other than Cougar Island are used and useful. The Cougar Island tract may be used and useful, but for the reasons stated below, we are disallowing all expenses related to the Cougar Island acquisition.

Based on this testimony, the Commission finds that KIU proved that the first two real estate transactions with its parent were reasonable and fair to KIU and that the interest expense associated with the loans to purchase two of the parcels should be allowed, especially since purchase clauses were contained in the approved lease agreements. For these same reasons, based on this testimony of witnesses Dennis and Heyboer, the Commission declines KPOG's request that the loans be disregarded and the purchase prices for the three parcels be treated as a dividend to the parent entity.

We do take issue with allowance of any expenses for the purchase of the Cougar Island tract. 26 S.C. Code Ann. Regs. 103-743 (Supp. 2011) requires that no utility shall execute or enter into any agreement or contract which would impact the utility's fitness, willingness, or ability to provide water service, without first submitting said contract in form to the Commission and the ORS and obtaining approval of the Commission. In the present case, the Company entered into an agreement wherein it would purchase the Cougar Island tract for future ASR purposes. This clearly impacts the Company's ability to provide water service. The Company failed to submit the contract for approval by this Commission, in violation of the regulation. Accordingly, we hold that all expenses for the Cougar Island tract must be disallowed. Should KIU wish to recover these expenses in future rate cases, it must submit the contract to this Commission for approval first.

Then we may consider whether or not the expenses are appropriate in the Company's next rate case.

We reject witness Lanier's requested range of common equity cost rate of 9.5% to 10.6%. We do not find it appropriate to establish a revenue requirement or to establish rates based on what appear to be estimated return on equity calculations or those adopted by this, or any other Commission, in previous cases in which different facts, circumstances, and economic conditions were at issue. We find persuasive witness Majewski's and witness Guastella's testimony regarding both a range and a recommended operating margin for KIU. We find that KIU, being a small regulated utility, should be permitted to choose to have its rates established on an operating margin basis. Witness Guastella testified to the reasons that the operating margin basis is fair and reasonable for a water and sewer utility of the size of KIU. Additionally, despite the evidence submitted by the Intervenor KPOG regarding the size and activities of KIU's parent corporation, KIU is the regulated utility and this Commission will, therefore, establish the appropriate income requirement and operating margin for KIU based on the Application and business records of that entity. For these reasons, we decline to adopt the return on equity analysis and recommendation offered by KPOG witness Lanier. We calculate the allowed operating margin based on the adjustments to income and expenses attested by the ORS witnesses and as further adjusted by the updated rate case expenses described in the next section.

We note that the ORS analysis included a federal income tax rate of 35%. Under the circumstances, it should have been 34%, as per the Intervenor testimony of witness

Blumenthal. Additionally, the Company's Application used the 34% federal income tax rate when computing income taxes after the proposed increase as noted on Schedule W-C 1, adjustment number 11 and Schedule S-C 1, adjustment number 11. We hold that we must apply the 34% rate to the present Application accordingly.

5. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 5

At the conclusion of the hearing in this matter, attorneys for KIU sought recovery of additional rate case expenses incurred in the Company's preparation of this rate case and moved that the Commission allow the inclusion of such expenses. Subsequent to the conclusion of the hearing, KIU did submit additional expenses to the ORS staff. ORS then reviewed and verified a total of \$57,341 in additional rate case expenses incurred and paid by the Company between the last response to ORS's information request dated October 5, 2011, and December 29, 2011. Based on ORS's review and recommendation of a five year amortization of such expenses, we conclude that KIU is entitled to rate case expenses of \$38,181; resulting from \$190,905 in total rate case expenses amortized over a period of five years.

We hereby approve an increase in the rate case expenses, from those presented into evidence at the hearing of \$133,564 (5 years = \$26,713 per year amortization), to \$190,905 (5 years = \$38,181 per year amortized). Based on our conclusion and finding, KIU is entitled to have the opportunity to earn revenues based on its amortization of actual and total rate case expenses in this matter.

6. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

Evidence concerning KIU's requested increase in rates and charges is evidenced by the Application filed by KIU, as well as the adjusted requested operating revenues as calculated by ORS witness Sullivan, as shown in Audit Exhibit DFS-1 of Hearing Exhibit No. 12, and KIU's Statement Of Compliance With PSC Interim Order.

7. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The Application of KIU shows per book test year total operating revenues of \$5,659,929. (Application, Schedule A-5). ORS presented testimony that the appropriate operating revenues for KIU for the test year under the present rates and after accounting and pro forma adjustments are \$5,697,698. This amount is based on the review of ORS, as evidenced in the testimony of ORS witnesses Majewski, as detailed in Exhibit HKM-3 of Hearing Exhibit No. 13, and Sullivan, as shown in Audit Exhibit DFS-1 of Hearing Exhibit No. 12. The ORS accounting and pro forma adjustments shown in the above referenced hearing exhibits were accepted and affirmed by KIU witness Guastella (Hearing Transcript, Pg. 270, Lines 1 – 9 and Pg. 252, Lines 11-16). Operating revenues for KIU during the test year were not directly addressed in the testimony of any of the witnesses of Intervenor KPOG.

We therefore find that the appropriate operating revenues for KIU for the test year under present rates and after accounting and pro forma adjustments are \$5,697,698.

8. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The total operating expenses of KIU during the test year according to the Company's Application were \$4,831,461 (Application, Schedule A-5). ORS calculated

KIU's operating expenses during the test year, after accounting and pro forma adjustments, to be \$4,897,827 (Hearing Exhibit No. 12, Audit Exhibit DFS-1). The difference of \$66,366, as discussed in ORS witness Sullivan's direct testimony, resulted from adjustments by ORS detailed in adjustments 9 through 15 in Audit Exhibit DFS-4 of Hearing Exhibit No. 12. At the hearing in this matter, KIU witness Guastella accepted all of the ORS adjustments; while also asserting that KIU was entitled to updated and final rate case expenses totaling approximately \$222,000 (Transcript, Pg.252, Line 11 to Pg. 253, Line 2). Final rate case expenses submitted by the Company for review by ORS totaled \$222,000. Based on its review of the \$222,000, ORS agreed to \$190,905 in total rate case expenses. We did note that ORS employed the 35% federal tax rate and included all expenses related to Cougar Island in its filing. The Commission finds that a 34% federal income tax rate is appropriate and that all expenses associated with Cougar Island should be removed. Accordingly, we hold that total as adjusted operating expenses shall be \$4,921,182.

KPOG witnesses Lanier and Blumenthal provided testimony and evidence regarding claimed adjustments to KIU's rate base, but as we find that the proper methodology for setting rates in this case is that of an operating margin methodology, and not a rate base or return on equity methodology, such evidence is irrelevant to the calculation of KIU's operating expenses used in calculating its income for return and operating margin.

KPOG witness Blumenthal also testified that depreciation or amortized expenses on sewer lines purchased by KIU from KRA should not be allowed and should be

removed from KIU's revenue requirement. We find no reason to disallow the purchase of sewer lines made by KIU from KRA. Witness Dennis testified that the sewer transmission lines in question were sold by KRA to KIU at their actual construction cost. KIU proved that the transaction was fair and reasonable. There is nothing in the record to indicate that the price paid by KIU for these sewer lines was excessive or higher than fair market value. In fact, KPOG's witnesses do not dispute that such sales were at fair market value but instead argue that KRA should have donated all property to KIU.

As testified to by KIU witness Guastella, there are no legal requirements or generally accepted industry practices which mandate or require the donation of water or sewer infrastructure by a developer, builder or other entity to the local utility. While KIU presented testimony from witness Dennis that the sewer lines were sold at their cost, there was no evidence presented by KPOG to challenge this proof that the prices paid by KIU to KRA for sewer lines in 2005 were at fair market value. We therefore reject KPOG's argument that the depreciation of these lines should be excluded from KIU's operating expenses.

9. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 9

The Commission adopts the customer growth methodology proposed by ORS without objection. After implementation of the rate increase approved in this order, customer growth will produce additional operating income of \$6,966.

10. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10 AND NO. 11

The evidence for the finding of fact concerning the amount of the requested rate increase is contained in the Application filed by KIU, in the testimony and exhibits of

KIU witness White, and in the testimony and exhibits of ORS witnesses Sullivan and Majewski. Based on the proposed Phase I rates in its Application, KIU sought an additional \$978,502 (23.1%) increase over existing water rates and an \$85,225 (5.6%) increase in sewer revenues. ORS witnesses Majewski and Sullivan made detailed accounting and pro forma adjustments which recalculated the Company's combined requested Phase I revenue increase to be \$1,046,694. Based on the Commission's finding of an appropriate Operating Margin of 13.75%, and including the additional rate case expenses previously addressed in this order and other factors mentioned above, we find that KIU is entitled to additional combined revenues of \$759,467. The approved increase in combined revenues equates to a 13.33% combined increase.

After ORS accounting and pro forma adjustments to revenues and expenses, ORS calculated that the Phase I rate increase requested by KIU would produce an Operating Margin of 15.15%. (Exhibit DFS-1 to Hearing Exhibit No. 12.) ORS witness Majewski testified that ORS recommended an operating margin, as was their usual practice in water and wastewater utility operating margin rate cases, of between 10% and 15%. (Transcript at Pg. 439, Lines 7 – 8 and Pg. 50, Lines 1 - 7.) Company witness Guastella additionally testified that he believed that an operating margin of 13.75% was needed by KIU to assure lenders of KIU's ability to repay such loans. The loan to which witness Guastella referred, is the approximately \$6,000,000 loan which KIU states that it will need to construct the second water supply line to the island. All parties agreed that a second water supply line is needed to assure a supply of potable water to Kiawah Island. KPOG's witnesses did not provide any meaningful analysis of operating margin.

The Commission concludes that operating margin, not return on equity, is the appropriate methodology for setting rates in this docket. In conclusion, based on the testimony and evidence presented to the Commission, we find that an approved Operating Margin of 13.75%, as previously found herein in Finding No.4, and including the additional rate case expenses found herein in Finding No. 5, this order produces an operating revenue requirement for KIU of \$6,457,165, which is an additional \$759,467 over the adjusted operating revenues for the test year of \$5,697,698.

11. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12

All parties in this matter agree that a second water supply line is needed by KIU to provide a reliable supply of water in the event of a disruption in the main service line. According to the testimony of witness Dennis, the existing supply line is more than 30 years old and subject to periodic breaks that interrupt service and result in considerable repair costs that have to be paid by KIU. At the hearing, though, KIU withdrew its requested “Phase II” rate increase as that request had been based on estimated costs of construction and therefore are not known and measurable.

In the testimony of ORS witness Majewski, ORS took the position that construction of a second water supply line would be both prudent and beneficial to the customers to avoid future interruptions in service. ORS was unable to verify the expenses related to the proposed second water supply line construction and therefore recommended the Commission deny approval of the “Phase II” rate increase. (Majewski direct testimony, Pg. 5, Line 9 through Pg. 6, Line 8.) KIU thereafter conceded that the request for Phase II rates was premature and withdrew this request. (Transcript, Pg. 88,

Line 8 through Pg. 90, Line 10.) We will not therefore rule on the prudence of the construction of the second water line to the island at this time.

12. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 13

All parties to this matter conceded or argued before the Commission their belief that the second water supply line, initially a part of the Application in this case as "Phase II" rates, is both desired and needed by both KIU and its customers.

In various forms KIU, KPOG, and KICA have all requested that this Commission keep this docket open to allow KIU to come back before this Commission to make a supplemental request for an increase in the water rates based solely on the proven cost of the new supply line. However, based on the number and complexity of objections and arguments made by the Intervenor in the present proceeding, we feel that it is inappropriate to hold this docket open. We do, however, acknowledge all parties' support for the construction of the second water supply line.

IV. Conclusions of Law

Based upon the Findings of Fact as set forth herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:

1. The Commission is vested with authority to regulate rates of every public utility in this state and to ascertain and fix such just and reasonable rates for service. S.C. Ann. § 58-5-210 (1976).

2. Operating Margin is the appropriate methodology in this case to fix just and reasonable rates for KIU. The Commission has carefully considered the various facts supporting the use of the Operating Margin in accordance with the admonition of the

Supreme Court of South Carolina in Heater of Seabrook, Inc. v. Public Service Com'n of South Carolina, 324 S.C. 56, 478 S.E.2d 826 (1996). The Commission further notes that the Supreme Court of South Carolina has implicitly approved the use of the Operating Margin in its prior decisions involving KIU, most recently in Kiawah Property Owners Group v. Public Service Com'n of South Carolina, 359 S.C. 105, 597 S.E.2d 145 (2004).

3. A regulated utility is entitled to "an opportunity to earn a fair and reasonable return." Southern Bell Telephone & Telegraph Co. v Public Service Comm. of S.C., 270 S.C. 590, 600, 244 S.E.2d 278, 283 (1978). An Operating Margin for KIU's combined water and sewer operations of 13.75% accomplishes a fair and reasonable return.

4. In accordance with past Commission practice, we approve the rate case expenses as reviewed by ORS in the amount of \$190,905.

5. For the test year ending December 31, 2010, the appropriate operating revenues, as adjusted in this Order, are \$5,697,698, and the appropriate operating expenses, as adjusted in this Order, are \$4,921,182. Where a regulated utility engages in transactions with an affiliate, proof of payment does not establish a prima facie case of reasonableness; rather the utility must establish that reasonableness and propriety of the services rendered and the reasonableness of the cost. Kiawah Property Owners Group v. Public Service Com'n of South Carolina, 338 S.C. 92, 525 S.E.2d 863 (1999); Kiawah Property Owners Group v. Public Service Com'n of South Carolina, 357 S.C. 232, 593 S.E.2d 148 (2004). As previously indicated, KIU established the reasonableness of the related party transactions in all respects, except with the Cougar Island transaction. Not

only does the Commission find that such transactions were reasonable, it has no authority over the developer owner to enter relief against it as requested by KPOG. Kiawah Property Owners Group v. Public Service Com'n of South Carolina, 357 S.C. 232, 593 S.E.2d 148 (2004).

6. Using the approved Operating Margin of 13.75%, KIU is permitted an overall revenue requirement of \$6,457,165.

7. In order for KIU to have an opportunity to earn the revenue requirement, KIU is allowed to establish rates and charges which will produce additional revenues of \$759,467.

8. The rates approved in this Order are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirement of the Company.

IT IS THEREFORE ORDERED THAT:

1. KIU shall be entitled to charge rates and fees, as contained in Appendix A, to obtain an Operating Margin of 13.75%.

2. The Company shall continue to maintain current performance bonds in the amounts of \$350,000 for water operations and \$350,000 for wastewater operations pursuant to S.C. Code Ann. § 58-5-720 (Supp. 2011).


3. The rates and schedules in Appendix A attached hereto are hereby adopted by the Commission. The Company is to provide thirty (30) days' advance notice of the increase to customers of its water and wastewater services prior to the rates and schedules

being put into effect for service rendered. The schedules shall be deemed to be filed with the Commission pursuant to S.C. Code Ann. § 58-5-240 (Supp. 2011).

4. The Company's books and records shall be maintained according to the NARUC Uniform System of Accounts. The Company is directed to make any necessary adjustments to its accounting system to conform to the NARUC Uniform System of Accounts.

5. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:



John E. Howard, Chairman

ATTEST:



David A. Wright, Vice Chairman

(SEAL)

Docket NO. 2011-317-WS
Order NO. 2012- 98
February 8, 2012

Appendix A

KIAWAH ISLAND UTILITY, INC.
31 Sora Rail Road
Johns Island, S.C. 29455
(843) 768-0641

Schedule of Rates and Charges

RATE SCHEDULE NO. 1 RESIDENTIAL SERVICE

AVAILABILITY - Available within the Company's service area.
APPLICABILITY - Applicable to any residential customer for any purpose.

Water Service Charges

A.	Base Facilities Charge	
	5/8" meter	\$29.92 / mo.
	3/4" meter	\$44.89 / mo.
	1" meter	\$74.81 / mo.
	1 1/2" meter	\$149.62 / mo.
	2" meter	\$239.40 / mo.
	3" meter	\$523.68 / mo.
	4" meter	\$1,502.90 / mo.

Base Facilities Charge for water service with meters larger than 4" shall be:
Maximum recommended meter capacity (gpm) x \$29.92 per mo.
20 gpm

B.	Consumption Charge	
	All up to 11,000 gals./mo.	\$3.06 /1000 gal.
C.	Excess Consumption Charge #1	\$3.51 /1000 gal.
	All over 11,000 gal./mo. and up to 50,000 gal./ mo.	
D.	Excess Consumption Charge #1	\$3.78 /1000 gal.
	All over 50,000 gal./mo.	

Sewer Service Charges

A.	Base Facilities Charge	
	5/8" water meter	\$22.86 / mo.
	3/4" water meter	\$34.29 / mo.
	1" water meter	\$57.15 / mo.
	1 1/2" water meter	\$114.29 / mo.
	2" water meter	\$182.87 / mo.
	3" water meter	\$400.03 / mo.
	4" water meter	\$1,236.78 / mo.

Base Facilities Charge for sewer service where water service is through meters larger than 4" shall be:
Maximum recommended meter capacity (gpm) x \$22.86 per mo.
20 gpm

B.	Consumption Charge based on Water Usage	
	All up to 11,000 gals./mo.	\$0.60 /1000 gal.

Tap-In Fees

Water Tap-In Fee	\$500.00
Sewer Tap-In Fee	\$500.00

The tap-in fee provides for installation of the normal size residential meter of 5/8" by 3/4".

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Where the customer requests a larger meter, the Company will apply the tap-in schedule for larger meters as listed in the Commercial Service Schedule No. 2.

RATE SCHEDULE NO. 2 COMMERCIAL SERVICE

AVAILABILITY - Available within the Company's service area.
APPLICABILITY - Applicable to any commercial or master metered residential customer for any purpose except hotel or motel use (see Rate Schedule No. 3).

Water Service Charges

A.	Base Facilities Charge	
	5/8" meter	\$29.92 / mo.
	3/4" meter	\$44.89 / mo.
	1" meter	\$74.81 / mo.
	1 1/2" meter	\$149.62 / mo.
	2" meter	\$239.40 / mo.
	3" meter	\$523.68 / mo.
	4" meter	\$1,502.90 / mo.

Base Facilities Charge for water service with meters larger than 4" shall be:
Maximum recommended meter capacity (gpm) x \$29.92 per mo.
20 gpm

B.	Consumption Charge	\$3.78 /1000 gal. for all consumption
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Sewer Service Charges

A.	Base Facilities Charge	
	5/8" water meter	\$22.86 / mo.
	3/4" water meter	\$34.29 / mo.
	1" water meter	\$57.15 / mo.
	1 1/2" water meter	\$114.29 / mo.
	2" water meter	\$182.87 / mo.
	3" water meter	\$400.03 / mo.
	4" water meter	\$1,236.78 / mo.

Base Facilities Charge for sewer service where water service is through meters larger than 4" shall be:
Maximum recommended meter capacity (gpm) x \$22.86 per mo.
20 gpm

B.	Consumption Charge based on Water Usage	\$2.34 /1000 gal. for all consumption
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Tap-In Fees

	<u>Water Tap-In Fee</u>	<u>Sewer Tap-In Fee</u>
5/8" meter	\$500.00	\$500.00
3/4" meter	\$750.00	\$750.00
1" meter	\$1,250.00	\$1,250.00
1 1/2" meter	\$2,500.00	\$2,500.00
2" meter	\$4,000.00	\$4,000.00
3" meter	\$8,750.00	\$8,750.00

Water tap-in fee and sewer tap-in fee for water and sewer service where the water meter is larger than 3" shall be:
Maximum recommended meter capacity (gpm) x \$500.00
20 gpm

RATE SCHEDULE NO. 3 HOTEL AND MOTEL SERVICE

- AVAILABILITY** - Available within the Company's service area.
APPLICABILITY - Applicable to all hotel and motel customers for any purpose.

Water Service Charges

Base Facilities Charge	\$12.02 /mo./room
All Consumption	\$3.78 /1000 gal.

Sewer Service Charges

Base Facilities Charge	\$9.14 /mo./room
All Consumption	\$2.34 /1000 gal.

Tap-In Fees

Water Tap-In Fee	\$220.00 /room
Sewer Tap-In Fee	\$220.00 /room

RATE SCHEDULE NO. 4 IRRIGATION SERVICE

- AVAILABILITY** - Available within the Company's service area. The Company reserves the right to limit or reduce the irrigation service available when, in its sole judgment, its water system conditions require such restrictions.
APPLICABILITY - Applicable only to customers who anticipate substantial potable water use which will not be returned to the Company's wastewater treatment system such as irrigation. Such water consumption shall be metered separately from any water use supplied under other rate schedules.

Water Service Charges

A.	Base Facilities Charge	
	5/8" meter	\$29.92 / mo.
	3/4" meter	\$44.89 / mo.
	1" meter	\$74.81 / mo.
	1 1/2" meter	\$149.62 / mo.
	2" meter	\$239.40 / mo.
	3" meter	\$523.68 / mo.
	4" meter	\$1,502.90 / mo.
	Base Facilities Charge for water service with meters larger than 4" shall be: <u>Maximum recommended meter capacity (gpm) x \$29.92 per mo.</u> 20 gpm	
B.	Consumption Charge	
	All up to 50,000 gals./mo.	\$3.51 /1000 gal.
C.	Excess Consumption Charge	\$3.78 /1000 gal.
	All over 50,000 gal./mo.	

Tap-In Fees

5/8" meter	\$500.00
3/4" meter	\$750.00
1" meter	\$1,250.00
1 1/2" meter	\$2,500.00
2" meter	\$4,000.00
3" meter	\$8,750.00

Water tap-in fee where the water meter is larger than 3" shall be:
Maximum recommended meter capacity (gpm) x \$500.00
20 gpm

RATE SCHEDULE NO. 5 FIRE HYDRANT SERVICE

- AVAILABILITY - Available within the Company's service area.
APPLICABILITY - Applicable to fire hydrants connected to Company water mains.

Water Service Charges

\$117.75 per hydrant per year payable semiannually in advance for fire fighting service.

When temporary water service from a hydrant is requested by a contractor or others, a meter will be installed and the charge will be:

\$8.00 for each day of use, PLUS \$4.17/1000 gals for ALL water used, PLUS a \$50 security deposit.

RATE SCHEDULE NO. 6 GOLF COURSE IRRIGATION

- AVAILABILITY - Available within the Company's service area.
APPLICABILITY - Applicable for golf course irrigation where the customer agrees to take as a minimum quantity the treated effluent from the wastewater treatment plant.

Water Service Charges

- | | | |
|----|--|-------------------|
| A. | Effluent water will be billed at a rate of: | |
| | Base Facilities Charge per Golf Course | \$3,795.53 / mo. |
| | Consumption | \$0.17 /1000 gal. |
| B. | Deep well water will be billed at a rate of: | |
| | Base Facilities Charge per Golf Course | \$929.79 / mo. |
| | Consumption | \$0.24 /1000 gal. |
| C. | Potable water will be billed at a rate of: | |
| | Base Facilities Charge per Golf Course | \$711.51 / mo. |
| | Consumption | \$3.78 /1000 gal. |

RATE SCHEDULE NO. 7 FIRE LINE SERVICE

- AVAILABILITY - Available within the Company's service area.
APPLICABILITY - Applicable for private fire lines.

Water Service Charges

Base Facilities Charge	
2" Line	\$7.08 / mo.
3" Line	\$12.92 / mo.
4" Line	\$22.40 / mo.
6" Line	\$44.80 / mo.

Tap-In Fees

2" Line	\$4,000.00
3" Line	\$8,750.00
4" Line	\$25,000.00

Water tap-in fee where the service is larger than 4" shall be based on the tap-in fee schedule as listed in the Commercial Service Schedule No. 2.

**CHARGES FOR SERVICE DISCONTINUANCE, RECONNECTION
AND OTHER MISCELLANEOUS SERVICE CHARGES**

1. When a customer requests discontinuance of service for reasons other than major repair, maintenance, or construction at the service address or for the transfer of possession or ownership of the service address, the Company may charge the equivalent of three months of basic facilities charges for both water and sewer service and require payment of such charges when for any reason service is restored to that particular customer.
2. Reimbursement of cost to make repairs to services or meters caused by others will be charged at actual cost as allowed per PSC Regulations 103-726 and R.103-733.5
3. Whenever service is disconnected for violation of rules and regulations, nonpayment of bills or fraudulent use of service, the Company may make a charge of \$50.00
4. Whenever service has been disconnected for reasons other than set forth in (3) above, the Company shall have the right to charge a \$25.00 reconnection fee to restore service.
5. Delinquent Notification Fee - \$10.00. A fee of \$10.00 shall be charged each customer to whom the Company mails a notice of discontinuance of service as required by the Commission rules prior to service being discontinued. This fee assesses a portion of the clerical and mailing costs of such notices to the customers creating that cost.
6. Customer Account Charge - \$25.00. One-time fee charged to each new account to defray costs of initiating service.
7. Return Check Charge (NSF) - \$25.00
8. DHEC Charge. If the South Carolina Department of Health & Environmental Control charges the Company an assessment based on customer units served by the Company, the Company may bill its customers for the applicable unit cost of that assessment. The charge shall be identified as a separate billed item and included in the total of the service billing.

PURCHASED WATER ADJUSTMENT

Kiawah Island Utility, Inc. ("Company") purchases its potable water from the St. John's Water Company ("St. John's"), which in turn purchases the water from the Commissioners of Public Works of the City of Charleston ("CPW"). Whenever CPW increases the price of water sold to St. John's, the increase in price is passed through to the Company pursuant to the water purchase agreement between the Company and St. John's.

The water purchase agreement also provides, as part of the purchased water price, a pro-rata share of St. John's annual operation and maintenance costs to be charged to the Company. Therefore, the Company's revenue requirement for purchased water is made up of the water unit price per thousand gallons and the operation and maintenance costs charged by St. John's.

Accordingly, whenever there is a price adjustment for the purchase of potable water to Kiawah Island Utility, Inc. by the St. John's Water Company, the following billing adjustment shall be made by the Company to its customer rates:

1. Billing Adjustment

In the event that St. John's adjusts (whether an increase or decrease) the unit price per 1,000 gallons and/or the operation and maintenance charges related to the purchase of potable water, the following billing adjustment practice would apply:

- (a) If the unit price is adjusted the cost change per 1,000 gallons would be passed through to the customers as an adjustment in like amount to the consumption charge on their water bill.

Example: The unit price of purchased water is increased by two cents per 1,000 gallons. The consumption charge on the customer's bill would reflect a two cent per 1,000 gallon increase.

- (b) If the pro-rata operation and maintenance charge is adjusted the cost change per 1,000 gallons (based on the most recent 12 months of potable water billed) would be passed through to the customers as an adjustment to the consumption charge on their water bill.

Example: The annual operation and maintenance charge is increased by \$18,000 and the most recent 12 months of potable water billed is 900,000 thousand gallons. The consumption charge on the customers bill would reflect a two cent per 1,000 gallon increase.

2. Notification

Any special billing adjustment shall not be billed until the following conditions are met:

- (a) The Company shall furnish the South Carolina Public Service Commission satisfactory proof of the basis for the adjustment and the billing method to be utilized at least sixty (60) days prior to its proposed effective date.
- (b) The Company shall furnish thirty (30) days prior written notice to the customers affected by the Purchased Water Adjustment advising them of the basis for the billing adjustment and its effective date.